STATEMENT

OF

C. KEITH MORTON
DIRECTOR, REGION IV
NATIONAL CREDIT UNION ADMINISTRATION

BEFORE THE

COMMITTEE ON COMMERCE AND CONSUMER PROTECTION

STATE OF MINNESOTA SENATE

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I. Introduction

The National Credit Union Administration (NCUA) appreciates this opportunity to present our views on the state of the credit union industry both nationally and in Minnesota to the Commerce and Consumer Protection Committee of the Minnesota State Senate.

Federal credit unions were created by the Federal Credit Union Act of 1934, while state-chartered credit unions have existed in Minnesota since 1925. Credit unions serve consumers in a manner similar to other financial institutions, but are operated as not-for-profit, member-owned cooperatives. Credit unions are governed by volunteer boards of directors, elected from the membership, and there are no outside stockholders or investors who are not members. Profits are returned to the membership in the form of better loan and dividend rates. Unlike other financial institutions, credit unions may only serve individuals within a restricted field of membership. Other financial institutions serve customers that generally have no membership interest.

Operationally, credit unions act as cooperative, not-for-profit financial service providers. Legally, at the federal level, credit unions also have the above mentioned restrictions on service, are limited as to the types of investments they can make and services they can provide, and also have a statutory mandate to serve consumers, particularly (but not exclusively) those of modest means. Credit unions fill a specialized role in the financial marketplace, one that the United States Congress has acknowledged as important in assuring consumers have access to basic financial services such as savings and affordable credit products. Credit unions comprise a small but important part of the financial services marketplace, accounting for just under 10 percent of consumer credit outstanding.[1]

[1] Federal Reserve Statistical Release G. 19, Consumer Credit, September 8, 2009

In the State of Minnesota, credit unions are locally owned and operated throughout the state. They range in size from over $2.2 billion in assets to $400,000. Regardless of size, these institutions provide consumers with essential financial services through a cooperative, not-for-profit structure.

Credit unions also contribute an important and tangible competitive effect on the overall financial marketplace, for both their members and non-members, by providing lower cost products and services. Researchers estimate the presence of credit unions in the marketplace saves non-credit union members (customers of other financial institutions) $4.3 billion annually,[2] due to the downward pressure on fees and costs, and upward pressure on rates paid. Additional studies have also shown that in many markets, credit unions provide a low cost alternative to abusive and predatory lenders. This research described the fees, rates, and terms of the largest United States credit card providers in comparison to credit cards issued by credit unions with similar purchase interest rates but with fewer fees, lower fees, lower default rates, and clearer disclosures. Credit unions offer products geared to the modest consumer at a reasonable price, such as very small loans and low-minimum balance savings products that many banks do not offer.[3]

When comparing the size and complexity of credit unions to banks, even the largest federally insured credit unions are relatively small. In fact, credit unions with less than $10 million in assets make up about 40 percent of the total number of credit unions nationwide. In the state of

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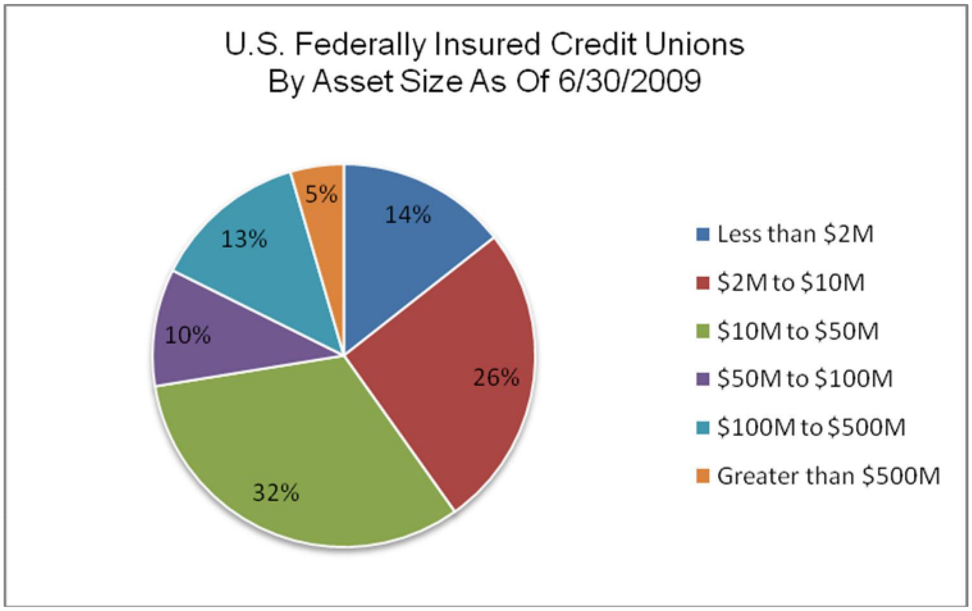
[2] An Estimate of the Influence of Credit Unions on Bank CD and Money Market Deposits in the U.S. - Idaho State University, January 2005. Also, An Analysis of the Benefits of Credit Unions to Bank Loan Customers – American University, January 2005. Increase in Bank Branches Shortchanges Lower-Income and Minority Communities: An Analysis of Recent Growth in Chicago Area Bank Branching. The Woodstock Institute, February 2005, Number 27.
3 Blindfolded Into Debt: A Comparison of Credit Card Costs and Conditions at Banks and Credit Unions. The Woodstock Institute, July 2005.

Minnesota, this number is similar at 39 percent.[4]



2. National Credit Union Administration Regulatory Oversight

The National Credit Union Administration is an independent federal agency. Its primary mission is to ensure the safety and soundness of federally insured credit unions. The NCUA performs this important public function by examining all federal credit unions, participating in the examination and supervision of federally insured state-chartered credit unions in coordination with state regulators, and insuring federally insured credit union members' accounts. In its statutory role as the administrator of the National Credit Union Share Insurance Fund (NCUSIF), the NCUA supervises over 7,600 federally insured credit unions and insures deposits of more than $711 billion nationwide. There are 156 federally insured credit unions in Minnesota, with deposits of more than $12 billion insured by the NCUSIF. All credit unions in Minnesota are federally insured by the NCUSIF and backed by the full faith and credit of the United States Government.[5]

[4] NCUA call reports, June 30, 2009.
[5] 12 U.S.C. §1785(a)(1)(B)

	Minnesota	United States
Federal Credit Unions	62	4,782
State Chartered Credit Unions	94	2,904
Total[6]	156	7,686

The NCUA has five regional offices, with the principal responsibility of examination and supervision of credit unions. Minnesota credit unions are under the supervision of Region IV, based in Austin, Texas. I am the Regional Director for Region IV and have been serving with the Agency for more than 22 years. The region's examination and supervision program is overseen by Associate Regional Director Larry Blankenberger, who has served the Agency for over 21 years.

The field supervisor for Minnesota is Crane Bennett who is based in the Minneapolis/St. Paul metro area; he also has responsibility for the state of North Dakota and part of Wisconsin. Mr. Bennett has 20 years of experience with the agency. Minnesota credit unions are primarily examined by 11 NCUA personnel; nine based in the Minneapolis/St. Paul metro area and two in Fargo, North Dakota. There are also three specialized NCUA staff with responsibilities in Minnesota: two Agricultural and Commercial Loan Specialists and an Economic Development Specialist who concentrates on small credit unions.

The NCUA performs examinations or supervision contacts at federally chartered credit unions at least once a year. The frequency of examinations is determined by a standard known by its acronym as the CAMEL Code. CAMEL stands for: Capital Adequacy, Asset Quality, Management, Earnings, And Liquidity (asset/liability management). Each area is given a rating of 1 through 5, with a 1 being the best rating. These five ratings are combined to assign a

[6] As of September 22, 2009

composite rating for each institution. Institutions rated a composite 1 or 2 are considered generally well managed and impose minimal risk to the insurance fund. Institutions rated a 3 pose a greater risk and are monitored more closely. Institutions rated 4 or 5 pose greater risk and are generally considered “Troubled Credit Unions” that are in danger of failure.

For credit unions that receive a CAMEL examination rating of 3, an on-site supervision contact is performed at least every six months; for credit unions coded a 4 or 5, onsite contacts are performed quarterly if not more often.

The NCUA employs a Risk Focused Examination Process (RFE). The RFE process is designed to be forward-looking, with more focus on management’s ability to identify and monitor current and potential areas of risk. It enables NCUA to allocate resources to credit unions exhibiting financial or management weaknesses or adverse trends. Examiners allocate time and apply the most scrutiny to activities posing the highest risk (i.e. risk-focused). Rather than evaluating a credit union solely on its performance to date or focusing on areas of minimal risk, examiners will evaluate both credit union performance and management’s ability to identify, measure, monitor, and control risk.

NCUA will perform joint examinations in concert with state regulators at state-chartered credit unions with assets greater than $500 million as well as credit unions with adverse trends, and credit unions with poor financial ratios. Supervision of state-chartered credit unions is performed similar to federal credit unions. The RFE process is also used on state-chartered credit unions, with NCUA staff usually focusing on the areas presenting the greatest risk.

NCUA monitors the financial condition of all federally insured credit unions through quarterly call reports, known colloquially as the ‘5300’ program (because of the form’s number). Field and regional staff review 5300 reports to monitor credit unions and determine if additional on-site supervision is needed. Using the 5300 reports, risk reports are produced showing credit unions with poor financial ratios, increasing amounts of risk, and unusual growth ratios. These risk reports are designed to give staff an additional tool to help monitor credit unions and identify problems in a timeframe where remedial actions can be applied.

3. Minnesota Credit Union Performance

The current economic difficulties have resulted in significant stress in all sectors of the financial services industry. While credit unions’ balance sheets have been affected, credit unions both nationally and in Minnesota continue to maintain good levels of capital, as measured by their net worth ratio. In fact, when compared to credit unions nationally as of June 30, 2009, Minnesota credit unions have higher net worth, and while delinquency levels are higher, they report fewer loan losses.

	Minnesota	United States
Net Worth to Assets	10.19%	10.03%
Problem Assets to Net Worth	8.42%	8.63%
Loan Delinquency	2.31%	1.58%
Loan Charge-Offs	0.98%	1.15%
Return on Assets	0.28%	0.28%
Operating Expenses to Assets	3.92%	3.77%
Loans to Assets	65.91%	65.51%
Asset Growth	9.03%	14.53%
Share Growth	10.57%	15.97%

As a whole, the net worth of Minnesota credit unions is well above the 7 percent of assets threshold necessary to be considered "Well Capitalized" per Prompt Corrective Action, as set forth in the Federal Credit Union Act.[7] As of June 30, 2009, there were only three Minnesota credit unions considered "Under Capitalized" with net worth less than 6 percent of assets. However, two of these credit unions are relatively new and have not had the time to accrue required amounts of capital. This is a common phenomenon among start-up credit unions.

As of September 22, 2009, 79 percent of Minnesota credit unions were rated a 1 or a 2. Minnesota only has 3 credit unions rated a 4 or 5.

CAMEL Rating	Minnesota	% of total	United States	% of total
1	27	17%	1,317	17%
2	96	62%	4,420	58%
3	30	19%	1,631	21%
4	3	2%	297	4%
5	0	0%	21	<1%

As a general rule, credit unions are conservatively run. While there are credit unions that pursue aggressive strategies, as a whole, Minnesota credit unions have not been significantly affected by the loans and investment products that have been the subject of market and media attention during the economic crisis:

- *Privately Issued Mortgaged Back Securities:* As of June 30, 2009, Minnesota credit unions held $263 million of privately issued mortgage-backed securities. This represents only 7.30 percent of total credit union investments and only 1.7 percent of total credit union assets. These risky investments are not a material part of Minnesota credit union balance sheets.

[7] 12 U.S.C. §1790(d)

- *Non-Traditional Lending Products:* Recent mortgage market turmoil suggests that interest-only and other non-traditional lending could carry a higher degree of risk than more traditional loans. However, credit unions have tended to stay away from these types of loans. As of June 30, 2009, Minnesota credit unions had $130 million in interest-only loans. This represents only 1.32 percent of total credit union loans and only 0.87 percent of total credit union assets. There are only 13 Minnesota credit unions reporting these loan products on their books as of June 30, 2009.

  Member Business Loans: While true that credit unions have been expanding into member business

  lending over the past several years, the vast majority of credit unions have no member business loans. Rather, it is primarily the larger credit unions (over $100 million) experiencing this growth. Even with this growth, member business loans as of June 30, 2009, were $839 million for Minnesota credit unions, only 8.50 percent of total loans and 5.60 percent of total assets.

Regardless of the relatively low exposure from these riskier products, NCUA closely supervises all types of credit union lending and investment activity. NCUA is mindful of the volatile and uncertain economic climate and has progressively increased staff in Minnesota since early 2008 in order to adequately and assertively manage any safety and soundness problems.

While most financial institutions have been adversely affected by the current economic crisis, Minnesota credit unions are strongly regulated by both federal and state agencies, remain strong and healthy, and continue to meet consumer financial needs in a safe and sound manner.